MULTIMEDIA UNIVERSITY

STUDENT IDENTIFICATION NO

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FINAL EXAMINATION

TRIMESTER 3, 2016/2017

BAC7044 – AUDIT THEORY AND PRACTICE

(MACC Weekend)

18 DECEMBER 2016
10:00 am – 1:00 pm
(3 Hours)

INSTRUCTIONS TO STUDENT

1. This Question paper consists of **5 pages** (excluding the cover page) with **4** Questions only.

2. Answer **ALL** Questions in the answer booklet provided

QUESTION 1 (25 marks)

You are a manager in Kasim & Partners, a firm of Chartered Certified Accountants, and you have taken on the responsibility for providing support and guidance to new members of the firm. Kasim & Partners has recently recruited a new audit junior, Mr. Samuel, who has come across several issues in his first few months at the firm, which he would like your guidance about. Samuel's comments and questions are shown below:

i- I know that auditors are required to assess risks of material misstatement by developing an understanding of the business risks of an audit client, but I am not clear on the relationship between business risk and risk of material misstatement. Can you explain the two types of risk, and how identifying business risk relates to risk of material misstatement?

ii- I worked on the interim audit of Chockee Sdn Bhd, a manufacturing company which outsources its payroll function. I know that for Chockee Sdn Bhd payroll is material. How does the outsourcing of payroll affect our audit planning?

iii- Kasim & Partners is facing competition from other audit firms, and the partners have been considering how the firm's revenue could be increased. I wonder, is it wrong if all audit managers promote to their audit clients that as well as providing the external audit service, Kasim & Partners can provide the internal audit service as part of an 'extended audit' service?

iv- I was aware that one of our client, Wawasan Bhd's Audit Committe refused to agree to an increase in audit fees despite the company's operations expanding into new locations. My guess is as a result, the materiality level was increased during the audit, and some review procedures were not carried out. Further, the auditor intended to select samples based on judgement rather than statistical methods. In serious case, a certain locations were not included in the sample of non-current assets selected for physical verification. Do you agree with me? Please advise.

Required:

For each of the issues raised, respond to the audit junior, explaining the ethical and professional matters arising from the comments.

(Total: 25 marks)

Continued...

QUESTION 2 (25 marks)

PART A

You are an audit manager in Sunny & Partners, working on the audit of the Time Group (the Group), whose financial year ended on 30 June 2015. This is the first time you have worked on the Group audit. The draft consolidated financial statements recognise profit before tax of RM6 million (2014 – RM9 million) and total assets of RM90 million (2014 – RM82 million). The Group manufactures equipment used in the oil extraction industry.

Goodwill of RM10 million is recognised in the Group statement of financial position, having arisen on several business combinations over the last few years. An impairment review was conducted in June 2015 by Ms. Sally, the Group Finance Director, and this year an impairment of RM50,000 is to be recognised in respect of the goodwill.

Sally has prepared a file of documentation to support the results of the impairment review, including notes on the assumptions used, his calculations, and conclusions. When she gave you this file, Sally made the following comment:

'I don't think you should need any evidence other than that contained in my file. The assumptions used are straightforward, so you shouldn't need to look into them in detail. The assumptions are consistent with how we conducted impairment reviews in previous years and your firm has always agreed with the assumptions used, so you can check that back to last year's audit file. All of the calculations have been checked by the head of the Group's internal audit department.'

Sally has also informed you that two members of the sales team are suspected of paying bribes in order to secure lucrative customer contracts. The internal audit team were alerted to this when they were auditing cash payments, and found significant payments to several new customers being made prior to contracts being signed. Sally has asked if Sunny & Partners would perform a forensic investigation into the alleged bribery payments.

Required:

a) Discuss how professional skepticism should be applied to the statement made by Sally.

(8 marks)

b) Explain the principal audit procedures to be performed on the impairment of goodwill.

(5 marks)

Continued...

c) Recommend the procedures to be used in performing a forensic investigation on the alleged bribery payments.

(5 marks)

PART B

A high-quality audit features the exercise of professional judgement by the auditor, and importantly, a mind-set which includes professional skepticism throughout the planning and performance of the audit.

Required:

Explain the meaning of the term professional skepticism, and discuss its importance in planning and performing an audit.

(7 marks)

(Total: 25 marks)

QUESTION 3 (25 marks)

PART A

Mariam Mazli encounters the following situations in doing the audit of a large auto dealership. Mariam is not a partner.

1) The sales manager tells her that there is a sale (at a substantial discount) on new cars that is limited to long-established customers of the dealership. Because her firm has been doing the audit for several years, the sales manager has decided that Mariam should also be eligible for the discount.

2) The auto dealership has an executive lunchroom that is free-of-charge to employees above a certain level. The controller informs Mariam that she can also eat there at any time.

3) Mariam is invited to and attends the company's annual Hari Raya party. When presents are handed out, she is surprised to find her name is included. The present has a value approximately RM200.

Required:

a) Assuming Mariam accepts the offer or gift in each situation, has she violated the rules of conduct?

(9 marks)

Continued...

b) Discuss what Mariam should do in each situation.

(9 marks)

PART B

"When Chartered Accountants (CAs) associates their names with compiled financial statements, their only responsibility is to the client and that is limited to the proper summarization and presentation on the financial statements of information provided by the client. The opinion clearly states that the auditor has not conducted an audit and does not express an opinion on this fair presentation. If users rely on compiled financial statements, they do so at their own risk and should never be able to hold the CAs responsible for inadequate performance. Users should interpret the financial statements as if they had been prepared by management."

Required:

Evaluate the above comments about compiled financial statements.

(7 marks)

(Total: 25 marks)

QUESTION 4 (25 marks)

PART A

Although Information Technology (IT) can improve a company's internal control, it can also affect the company's overall control risk. Many risks in manual systems are reduced and in some cases eliminated. However, there are risks specific to IT systems that can lead to substantial losses if ignored. If IT systems fail, organisations can be paralysed by the inability to retrieve information or by the use of unreliable information caused by processing error. These risks increase the likelihood of material misstatements in financial statements.

Required:

Discuss the risks for accounting systems that rely heavily on IT functions.

(9 marks)

Continued...

PART B

There has been an alarming increase in lawsuits against external auditors. Efforts have been taken by concerned parties on how to ensure such lawsuits are reduced.

Required:

a) Identify the elements to be proven by third parties in order to succeed in an action for negligence against the external auditor.

(4 marks)

b) Describe any four ways that can be taken by individual chartered accounting firm to reduce potential claims from such lawsuits.

(5 marks)

PART C

"The environment of public sector auditing has increasingly included demands for auditors to place less emphasis on the financial and regularity audits and more on value for money. Auditors have responded with auditing standards and have developed methodologies for the three Es audits" (Jones and Pendlebury, 2000).

Required:

Discuss the three steps in a 3 "E" audit.

(7 marks)

(Total: 25 marks)

End of Paper